

# Overview, Requirements, and Guidelines for the Personal Property Audit Grant Program

## I. OVERVIEW OF PERSONAL PROPERTY AUDIT GRANT PROGRAM

- A. **Purpose:** Section 926 of Public Act 161 of 2003, provides up to \$7 million for grants to cities, townships, and counties for the sole purpose of paying a portion of the costs for personal property audits as provided by MCL 211.22a of the Michigan General Property Tax Act. The focus of the grant program will be to award funding to those local units that best demonstrate a detailed plan to fairly and efficiently expand and improve the personal property audit process. Focus should be placed on discovery of omitted or incorrectly reported property as provided by MCL 211.154 of the Michigan General Property Tax Act.
- B. **Conditions for Grants:** The local unit(s) must comply with Sections II – V of this document in order to be considered for a grant.
- C. **Local Financial Component:** The local unit(s) must demonstrate a contribution to the total cost of performing personal property audits.
- D. **Timing for Audit Completion:** Grant funds that were awarded as part of the 2003-application process may only be used for audits completed prior to September 30, 2004. Grant funds awarded after June 1, 2004, may be used for audits completed by September 30, 2005. Exceptions may be made for good cause; requests must be made in writing to the Department of Treasury prior to September 30 of the year in which the grant award expires.
- E. **Grant Consideration:** The Department of Treasury, in evaluating an application, will consider the extent to which the proposal addresses the guidelines of Section VI of this document. Local units may wish to consider filing a joint application or working with their County Equalization office to coordinate an application approach for tax parcels that overlap multiple political jurisdictions. Priority will be given to those applicants that best demonstrate a detailed and fair plan. Consideration will also be given to the total number of personal property parcels in the jurisdiction(s). An application should explain current efforts of personal property tax audits and long term plans to continue auditing all personal property. For the most part, it is anticipated that a grant will be used to hire a qualified audit firm, particularly where complex audits are involved, and to provide staff training.
- F. **2004 Application Due Date:** For equal consideration, grant applications are due no later than June 11, 2004. Applications may still be filed after this date.
- G. **2004 Grant Awards:** The Department of Treasury expects to offer grant awards by the end of July 2004. Additional awards may be made depending on the availability of funding.
- H. **Funding Availability:** The Grant Program will be reimbursement for audits completed. Reimbursements are expected to be made on a quarterly basis.

## **II. MANDATORY REQUIREMENTS FOR LOCAL UNIT PERSONAL PROPERTY AUDIT PROGRAMS**

- A. The following are mandatory requirements for audit plans that must be met by cities, townships, or counties (also described as local units) that wish to use grant money as authorized by Section 926 of Public Act 161 of 2003.
1. The plan may only include activities which fit into one of the three following categories as provided by MCL 211.22a:
    - a. Auditing the books and records of owners of personal property to determine omitted or incorrectly reported property,
    - b. Training local unit employees to become certified personal property examiners,
    - c. Training local unit employees to audit the books and records of personal property owners.
  2. If a local unit already has an auditing program, the plan must be for activities that exceed recent baseline audit activity.
  3. A portion of the costs of the audit program must come from local taxing jurisdictions.
  4. Even if the local unit has not conducted or is not required under its local regulations to conduct a "Request for Qualifications" or a "Request for Proposal" as part of its selection process for a third party audit firm, then at a minimum a "Request for Quotes" for services from qualified vendors must be conducted from multiple firms and must still be completed prior to the selection of the audit firm. Please note that this does not apply to work performed under existing contracts entered into prior to September 15, 2003.
  5. Neither the salaries of employees nor fees paid to third party auditors may be based in whole or in part on a contingency fee arrangement. The fee cannot be contingent upon additional assets discovered or additional taxes collected.
  6. The auditing firm, affiliates, employees or subcontractors must meet the requirements outlined in Section III.
  7. For the 2004 grant awards, audits covered by a grant must be completed by September 30, 2005, except as may be authorized by the Department of Treasury prior to September 30, 2005.
  8. A local unit contract with a third party audit firm must meet requirements outlined in Section IV.
  9. If employees of the local unit perform audits, they must comply with the conditions outlined in Section V.

10. The local unit must file petitions under MCL 211.154 for the current year and two prior years within 30 days of the completion of an audit if the audit indicates that there is omitted property, unless there is good cause for delaying or not filing the petition.
11. The local unit must defend assessments which are appealed to the State Tax Commission (STC) and the Michigan Tax Tribunal. However, this requirement does not preclude settlement of a matter before the Tribunal or the STC.
12. The grant recipient must provide reports summarizing the number of completed audits to the Michigan Department of Treasury. Payment of the grant will be on a reimbursement basis and will be based on these reports. The Department will prescribe the form of the report.
13. A grantee must execute a grant agreement with the Michigan Department of Treasury in which it agrees that receipt of funds is based on complying with the conditions outlined above.

### **III. MANDATORY CONFLICT OF INTEREST DISCLOSURE REQUIREMENTS**

- A. An auditing firm shall provide the names of all of its clients and of all clients of its affiliate firms who are, or may be, part of the population being audited prior to signing a contract or as soon as practical if an existing contract is in place. The auditing firm may not audit the personal property records of any taxpayer for which it is or has provided consulting, accounting, tax or attestation services. After full disclosure of any relationship that it may have, an audit firm that is an affiliate of an accounting firm that is or has provided consulting, accounting, tax or attestation services for a taxpayer within the local unit may audit that taxpayer's records if adequate safeguards acceptable to the Michigan Department of Treasury and the auditing local unit are first implemented to assure that confidentiality and independence are maintained. If an auditing firm's affiliate has engaged in significant activity directly related to the taxpayer's personal property tax reporting, approval of the auditing firm may be withheld. The audit firm or affiliate firm includes all employees of these firms, including part-time employees.
- B. The name, qualifications and purpose for which the auditing firm intends to retain the services of sub-contracted persons must be disclosed prior to signing a contract, or as soon as practical, if an existing contract is in place. Subcontractors must comply with and are subject to the preceding paragraph.

### **IV. CONTRACT REQUIREMENTS FOR PERSONAL PROPERTY AUDIT SERVICES**

- A. An agreement between the local unit and the auditing firm must be in writing and signed.
- B. All persons performing audit activities involving contact with taxpayers must be certified as Personal Property Examiners by the Michigan State Tax Commission, as provided in MCL 211.22a.
- C. In addition to being certified as a Personal Property Examiner, any person performing audit activities involving contact with taxpayers must have three year's full-time experience, or the equivalent in part-time experience, in performing personal property

audits on behalf of governmental units, unless the person is acting under the direct and active supervision of another person who meets this experience requirement.

- D. An auditing firm may not be retained on a contingency fee basis. The fee cannot be contingent upon additional assets discovered or additional taxes collected. A set fee agreement must be made that is based on the size and complexity of the audit and/or other relevant factors. The fee arrangement must provide that the fee will be inclusive of any and all costs, including but not limited to, travel expenses and the cost of attending administrative and/or legal proceedings. Fees for the performance of an audit must not become payable until the audit has been completed and the audit report has been provided to the taxing jurisdiction.
- E. The auditing firm must agree, to the fullest extent permitted by laws and regulations, to indemnify and hold harmless the State of Michigan and the local jurisdiction, and its officials, agents and employees, from and against any and all claims, damages, losses and expenses, direct, indirect or consequential (including, but not limited to fees and charges of engineers or architects, attorneys and other professionals and costs related to court action or arbitration) arising out of, or resulting from the performance of, the agreement or the actions of the auditing firm or its officials, employees or contractors under the agreement or the agreements entered into by the auditing firm in connection with the agreement. The agreement must provide that indemnification will survive the termination of the agreement.
- F. The agreement between the local unit and the audit firm must include agreements on the part of the audit firm:
  - 1. To properly prepare all necessary MCL 211.154 documentation for the assessor's or equalization director's signature;
  - 2. To appear, without additional charge or reimbursement of costs, at all administrative, tribunal, and court proceedings for the purpose of providing testimony, consultation, or both;
  - 3. To travel to the locations where the taxpayer records are kept even in cases where the location is outside the State of Michigan. Taxpayer records are defined by Department of Treasury Form L-4175;
  - 4. To notify the assessor or equalization director of possible omitted real property, omitted personal property, or both owned by taxpayers not being audited, when such possible omitted property is discovered during the course of an audit;
  - 5. To conduct an on-site inspection of the facility that is being audited (in cases where the taxpayer has an established business location in the jurisdiction). During this inspection, a property inventory shall be taken or an inventory of a sampling of property shall be taken for the purpose of verifying the completeness and accuracy of the taxpayer's fixed asset records.
  - 6. To develop and provide to the local unit a written audit program for conducting personal property taxation audits in Michigan, that will be used as a means of guiding the audit staff in their work and as a means of allowing the local unit to judge whether all appropriate procedures have been completed. The auditing firm

may adopt the suggested audit program developed by the Property Tax Division of the Michigan Department of Treasury. The audit program will be a practical guide that is used in the completion of a given audit but will recognize that some procedures may not be necessary or appropriate in a given audit situation. The assessed value of the taxpayer and the outcome of initial audit procedures may be considered in determining the extent of the audit procedures.

7. To maintain confidentiality of its workpapers and taxpayer documents and records, in accordance with the requirements of MCL 211.23.
  8. That all workpapers are the property of the local jurisdiction.
  9. That the auditing firm is an agent for the local unit only and the auditing firm will not represent to any taxpayer or taxpayer's agent or representative, that it is acting on behalf of, or is an agent for, the State of Michigan.
- G. The agreement must provide that, upon completion of each audit, the audit firm will conduct an in-person exit interview. The audit firm must provide the local unit with a copy of the minutes of each exit interview. The taxpayer shall be provided a short written summary of the audit results and an explanation of any matters the auditor deems significant. The taxpayer may request an explanation of specific audit determinations. Reasonable efforts shall be made to conduct the exit interview in person. If a taxpayer does not cooperate in the scheduling of an interview, the minutes shall reflect that reason for not scheduling the exit interview.
- H. The agreement between the local unit and the auditing firm shall provide that the following must be accomplished in order for an audit to be deemed complete. The auditor's workpapers must include all of the following:
1. The minutes of one or more interviews with representatives of the taxpayer who have personal operational knowledge of the financial record keeping practices of the taxpayer and personal operational knowledge of the activity that is carried on at the taxpayer location(s) in the jurisdiction. Interviews with tax representatives who lack personal operational knowledge are not sufficient.
  2. The record of personal inspection of the taxpayer's location in the jurisdiction.
  3. A complete and comprehensive listing of the taxpayer's fixed assets in the local unit on each of the most recent three assessment dates and a reconciliation between that listing and the listing of assets used to calculate the taxpayer's proposed assessments for each of those three assessment dates. This document may be in an electronic medium. If the business has an operating history less than three years, then the audit workpapers must include information as of the date of operation.
  4. Materials which evidence the documentation and process(es) used to authenticate the listing of the taxpayer's fixed assets, relating to the audit program.
  5. A listing of the specific procedures in the audit program that were actually performed.

6. The real property record card(s) used as the basis for determining the allocation of fixed assets expenditures between the real property assessment(s) and the personal property assessment(s).
  7. Pro forma personal property statements of the taxpayer for each of the most recent three assessment dates and a calculation of the assessment for each statement. If the business has an operating history less than three years, then the audit workpapers must include information as of the date of operation.
- I. If the auditing firm employs the services of subcontracted persons, it shall secure and provide to the local unit a conflict of interest statement and a written agreement by the subcontracted person to comply with and be bound by the auditing firm's agreement with the jurisdiction. Subcontracting is limited to no more than 30% of the proposed personal property audit work plan and this limit must be reflected in the contract.
  - J. The agreement between the auditing firm and the local unit must provide that the auditor will be available in person for consultation and attendance at meetings when necessary to resolve issues that have arisen from the audit process.
  - K. The local unit retains control of the selection of audit subjects and over all aspects of the audit plan and program.

## **V. REQUIREMENTS FOR AUDITS PERFORMED BY EMPLOYEES**

- A. If an employee of a local unit of government performs audits, those audits must be based on a written audit program developed to support the audit activity. The auditor's workpapers must include all of the following:
  1. Minutes of one or more interviews with representatives of the taxpayer who have personal operational knowledge of the financial record keeping practices of the taxpayer and personal operational knowledge of the activity that is carried on at the taxpayer location(s) in the jurisdiction. Interviews with tax representatives who lack personal operational knowledge are not sufficient.
  2. The record of personal inspection of the taxpayer's location in the jurisdiction.
  3. A complete and comprehensive listing of the taxpayer's fixed assets in the local unit on each of the most recent three assessment dates and a reconciliation between that listing and the listing of assets used to calculate the taxpayer's proposed assessments for each of those three assessment dates. This document may be in an electronic medium. If the business has an operating history less than three years, then the audit workpapers must include information from the date that operations were commenced.
  4. Materials which evidence the documentation and process(es) used to authenticate the listing of the taxpayer's fixed assets, relating to the audit program.
  5. A listing of the specific procedures in the audit program that were actually performed.

6. The real property record card(s) used as the basis for determining the allocation of fixed assets expenditures between the real property assessment(s) and the personal property assessment(s).
7. Pro forma personal property statements of the taxpayer for each of the most recent three assessment dates and a calculation of the assessment for each statement. If the business has an operating history less than three years, then the audit workpapers must include information as of the date of operation.

## **VI. GUIDELINES FOR CONSIDERATION OF LOCAL PERSONAL PROPERTY PROGRAMS AND AUDITOR QUALIFICATIONS**

**A. Additional Program Guidelines:** The following are additional guidelines for cities, townships, and counties (also described as local units) that wish to use grant money as authorized by Section 926 of Public Act 161 of 2003. The Department will take the extent to which an applicant addresses these issues into consideration when evaluating a grant application.

1. A plan for training the local unit's employees to perform its own audits, if the local unit does not have a certified personal property examiner in its employ.
2. A statement of the criteria for selecting audit subjects. The local unit's total audit program should not target a particular taxpayer or class of taxpayer unless cause is shown. A random selection process may be stratified under appropriate circumstances.
3. In general, the Department recommends that third party audits focus on taxpayers whose assets are assessed greater than \$25,000, unless the local unit has reason to believe a taxpayer is significantly under-reporting.
4. The Department recommends the local unit should have a plan to audit taxpayers who are assessed at \$25,000 or less.
5. A plan demonstrating continuation of audits of personal property and enforcement of tax compliance after the completion of the grant program.
6. A program for canvassing the jurisdiction.
7. Substantial local financial commitment.
8. Augmentation of current audit activity.

**B. Additional Guidelines for Evaluating Auditor Qualifications:** The Department will consider the extent to which an applicant demonstrates the following:

1. The auditing firm is prepared to demonstrate that its full and part-time staff and its contractors have sufficient knowledge of accounting procedures, methods and terminology so that they will successfully complete the contemplated audit activity. In all cases, this knowledge should include an understanding of the meaning and practical application of concepts such as capitalization, capitalized cost, direct cost,

indirect cost, construction in progress, amortization, expensing, acquisition date, placed-in-service dates, leasehold improvements, real property, tangible personal property, intangible personal property, fixed assets, and trade fixtures and should include familiarity with the examination procedures that are applicable to accounting documents such as fixed asset listings, depreciation schedules, lapse schedules, expense journals, adjusted trial balances, charts of account, general ledgers, balance sheets, income statements, and audited financial statements. If the audit program will include taxpayers that are large industrial facilities, multi-jurisdictional, publicly traded, or the product of an acquisition, reorganization, or merger process resulting in the application of the purchase method or similar asset revaluation procedures, then the auditing firm should also demonstrate that it has the experience and advanced accounting knowledge to accomplish the more complex audit procedures required for such taxpayers.

2. The auditing firm is prepared to demonstrate that its full and part time staff and its contractors possess a sufficient understanding of Michigan tax laws, policies, case law, rules, regulations and procedures to successfully complete the audit activity in accordance with the requirements of the Michigan State Tax Commission in its consideration of petitions filed pursuant to MCL 211.154.
3. The auditing firm is able to demonstrate that it has sufficient qualified staff available to properly complete the audit project. To this end, the firm should indicate the proposed schedule of progress toward completion of the audit program in the jurisdiction, should provide the name(s) and qualifications of the lead auditor(s) for the project, should provide a tentative list of the names of the staff to be assigned to the project and their qualifications and should provide a description of any other projects to which the named lead auditor(s) and staff member(s) have been assigned.
4. The auditing firm is able to demonstrate that it has the financial resources to complete its obligations under the audit agreement, including the ability to carry out its responsibilities during the period between commencement of the project and completion of any given audit, the ability to hire and retain adequate staff and/or contractors, the ability to meet its financial obligations as they fall due in the normal course of business, and the ability to meet its indemnification obligations under the agreement.